DEPARTMENT OF STATE REVENUE

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Letter of Findings: 01-20170961
Indiana Individual Income Tax
For The Tax Year 2012

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

HOLDING

Individual was liable for additional Indiana income tax for the 2012 year because she received 1099-C income but failed to substantiate that she was insolvent immediately before August 17, 2012, the discharge of her $146,140 mortgage loan debt.

ISSUE

I. Indiana Individual Income Tax - Exclusions - Insolvency.

Authority: I.R.C. § 61; I.R.C. § 108; IC § 6-3-1-3.5; IC § 6-3-2-1; IC § 6-3-2-2; IC § 6-8.1-5-1; *Gitlitz v. Comm'r*, 531 U.S. 206 (2001); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007); *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc*., 963 N.E.2d 463 (Ind. 2012); *Miller Brewing Co. v. Indiana Dep't of State Revenue*, 903 N.E.2d 64 (Ind. 2009); *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96 (Ind. Ct. App. 1974); *Indiana Dep't of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454 (Ind. Ct. App. 1988); *Stinson Estate v. United States*, 214 F.3d 846 (7th Cir. 2000); *Merkel v. C.I.R.*, 192 F.3d 844 (9th Cir. 1999); *Gale v. C.I.R.*, 2006 WL 2639504 (Tax Ct. 2006); *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480 (Ind. Tax Ct. 2012).

Taxpayer protests the Department's assessment of individual income tax for 2012.

STATEMENT OF FACTS

Taxpayer ("Wife") resides and works in Indiana. Taxpayer did not file her Indiana income tax return (Form IT-40) for the 2012 tax year. In 2015, the Indiana Department of Revenue ("Department") assessed Taxpayer 2012 income tax based on the best information available to the Department at that time. Taxpayer did not respond to the Department's proposed assessment. As a result, Taxpayer's bank account was levied and her subsequent tax refunds were offset.

In 2017, Taxpayer filed her IT-40 return and enclosed a copy of her federal return, Form 1040, for the year 2012. In that federal return, Taxpayer and her spouse ("Husband") elected "married filing separately" to report their income for federal and Indiana income tax. Upon review, the Department determined that, in addition to her income from wages (Form W-2), Taxpayer also received taxable income (Form 1099-C), in the amount of $146,140. That 1099-C represented a mortgage loan debt forgiven by her lender/creditor on August 17, 2012. The Department thus made an adjustment which resulted in additional assessment of income tax.

Taxpayers timely protested the assessment. An administrative hearing was held. This Letter of Findings ensues and addresses Taxpayer's protest of the proposed assessment. Additional facts will be provided as necessary.

I. Indiana Individual Income Tax - Exclusions - Insolvency.

DISCUSSION

Upon a review of Taxpayer's 2012 IT-40, the Department determined that Taxpayer had an additional $146,140 income pursuant to a 1099-C Form. Taxpayer disagreed, arguing that the 1099-C income was excluded and not subject to Indiana income tax because she was insolvent immediately before the cancellation of her $146,140 debt. Thus, the issue is whether Taxpayer demonstrated that she was insolvent immediately before her creditor cancelled her debt and therefore the income attributable to cancellation of debt (1099-C income) was exempt from Indiana income tax.

As a threshold issue, all tax assessments are *prima facie* evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue,* 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007); *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc*., 963 N.E.2d 463, 466 (Ind. 2012). "[E]ach assessment and each tax year stands alone." *Miller Brewing Co. v. Indiana Dep't of State Revenue*, 903 N.E.2d 64, 69 (Ind. 2009). Thus, the taxpayer is required to provide documentation explaining and supporting its challenge that the Department's assessment is wrong. Poorly developed and non-cogent arguments are subject to waiver. *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012).

Indiana imposes a tax "on the adjusted gross income of every resident person, and on that part of the adjusted gross income derived from sources within Indiana of every nonresident person." IC § 6-3-2-1(a). IC § 6-3-2-2(a) specifically outlines what is income derived from Indiana sources and subject to Indiana income tax. For Indiana income tax purposes, the presumption is that a taxpayer files his or her federal income tax returns as required pursuant to the Internal Revenue Code. Thus, to efficiently and effectively compute what is considered the taxpayer's Indiana income tax, the Indiana statute refers to the Internal Revenue Code. IC § 6-3-1-3.5(a) provides the starting point to determine the taxpayer's taxable income and to calculate what would be his or her Indiana income tax after applying certain additions and subtractions to that starting point, with modifications thereafter. Modifications to a resident taxpayer's adjusted gross income are outlined in IC § 6-3-1-3.5(a).

While IC § 6-3-1-3.5(a) mandates certain income to be added back to a taxpayer's adjusted gross income (such as, discharge of debt of a principal residence), it also allows certain income to be subtracted from the taxpayer's adjusted gross income. For instance, IC § 6-3-1-3.5(a)(1) specifically provides, "Subtract income that is exempt from taxation under this article by the Constitution and statutes of the United States." One example is "discharge of indebtedness," which generally gives rise to gross income to a debtor-taxpayer under I.R.C. § 61(a)(12); *see Gitlitz v. Comm'r,* 531 U.S. 206, 213 (2001). Nonetheless, I.R.C. § 108 (in effect during the 2012 year) provides certain exceptions to this general rule, which states, as follows:

(a) Exclusion from gross income.-
(1) In general.-Gross income does not include any amount which (but for this subsection) would be includible in gross income by reason of the discharge (in whole or in part) of indebtedness of the taxpayer if-
(A) the discharge occurs in a title 11 case,
(B) **the discharge occurs when the taxpayer is insolvent**,
(C) the indebtedness discharged is qualified farm indebtedness,
(D) in the case of a taxpayer other than a C corporation, the indebtedness discharged is qualified real property business indebtedness, or
(E) the indebtedness discharged is qualified principal residence indebtedness which is discharged before January 1, 2013.
(2) Coordination of exclusions.-
(A) Title 11 exclusion takes precedence.-Subparagraphs (B), (C), (D), and (E) of paragraph (1) shall not apply to a discharge which occurs in a title 11 case.
(B) Insolvency exclusion takes precedence over qualified farm exclusion and qualified real property business exclusion.-Subparagraphs (C) and (D) of paragraph (1) shall not apply to a discharge to the extent the taxpayer is insolvent.
(C) Principal residence exclusion takes precedence over insolvency exclusion unless elected otherwise.-Paragraph (1)(B) shall not apply to a discharge to which paragraph (1)(E) applies unless the taxpayer elects to apply paragraph (1)(B) in lieu of paragraph (1)(E).
(3) **Insolvency exclusion limited to amount of insolvency.-In the case of a discharge to which paragraph (1)(B) applies, the amount excluded under paragraph (1)(B) shall not exceed the amount by which the taxpayer is insolvent.**
. . .
(d) Meaning of terms; special rules relating to certain provisions.-
(1) **Indebtedness of taxpayer.-For purposes of this section, the term "indebtedness of the taxpayer" means any indebtedness-**
(A) for which the taxpayer is liable, or
(B) subject to which the taxpayer holds property.
. . .

> (3) Insolvent.-For purposes of this section, the term "insolvent" means the excess of liabilities over the fair market value of assets. With respect to any discharge, whether or not the taxpayer is insolvent, and **the amount by which the taxpayer is insolvent, shall be determined on the basis of the taxpayer's assets and liabilities immediately before the discharge**. . . . (**Emphasis added**).

Taxpayer here is relying on the statutory exemption pursuant to IC § 6-3-1-3.5(a)(1) based on I.R.C. § 108(a)(1)(B). A statute which provides a tax exemption is strictly construed against the taxpayer. *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *Id*. at 101 (internal citations omitted). In applying any tax exemption, the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." *Indiana Dep't of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988). *See also Stinson Estate v. United States*, 214 F.3d 846, 848 (7th Cir. 2000)(explaining "that Internal Revenue Code provisions dealing with deductions, exemptions, and exclusions are matters of legislative grace. The exclusion must be narrowly construed, and the [taxpayer] has the burden . . . .").

The federal tax court in *Gale v. C.I.R.* further illustrated, in part, as follows:

> Pursuant to one of these exceptions, income from discharge of indebtedness is excluded from gross income if the discharge occurs when the taxpayer is insolvent. The amount of income from discharge of indebtedness excluded under section 108(a)(1)(B) is not to exceed the amount by which the taxpayer is insolvent. Sec. 108(a)(3). For purposes of section 108, the term "insolvent" means the excess of liabilities over the fair market value of assets. Sec. 108(d)(3). Whether the taxpayer is insolvent, and the amount by which the taxpayer is insolvent, is determined on the basis of the taxpayer's assets and liabilities immediately before the discharge. *Gale*, 2006 WL 2639504, at *2 (Tax Ct. 2006); *see also Merkel v. C.I.R.*, 192 F.3d 844 (9th Cir. 1999).

In this instant case, Taxpayer reported only the W-2 income in her 2012 IT-40 pursuant to her "married filing separate" status. The Department determined that, in 2012, Taxpayer received additional income, namely, "Cancellation of Debt" ("1099-C") income. The debt in question stemmed from a mortgage loan Taxpayer borrowed from the lender/creditor, using a cottage that she and Husband jointly owned. The 1099-C at issue stated that the discharge occurred "August 17, 2012." Taxpayer did not claim that cottage was used as business property or her principal residence. Nor did Taxpayer initiate a bankruptcy petition before "August 17, 2012." Rather, Taxpayer, referencing I.R.C. § 108(i), asserted that the 1099-C income was excluded from her income for income tax purposes because she was insolvent immediately before the discharge of $146,140 debt. To support her protest, Taxpayer submitted a Form 982 (claiming a $146,140 net operating loss in line 6), a Worksheet (from the Publication 4681), several delinquent statements from various creditors concerning Husband's credit cards and mortgage loans.

Thus, the issue is whether Taxpayer's supporting documentation demonstrated that she was insolvent immediately before her creditor cancelled her debt; therefore, the 1099-C income was exempt from Indiana income tax pursuant to IC § 6-3-1-3.5(a)(1).

Upon review, however, Taxpayer's reliance of the "insolvency" under I.R.C. § 108 is misplaced. Specifically, Taxpayer in this instance elected the "married filing separate" status to report her federal and Indiana income. Therefore, for the purpose of I.R.C. § 108(a)(1)(B), Taxpayer was required to exclude Husband's liabilities. Taxpayer's supporting documentation demonstrated that all of the above-mentioned delinquent statements were under Husband's name. Thus, the Department is unable to accept that Taxpayer had approximately $400,000 liability immediately before "August 17, 2012" when the creditor discharged the debt. Taxpayer's documentation demonstrated that, immediately before August 17, 2012, she had $0 liability.

Likewise, when Taxpayer elects the "married filing separate" status to report her federal and Indiana income, Husband's assets generally would have been excluded from Taxpayer's assets for I.R.C. § 108 (a)(1)(B) purposes, unless the assets are jointly owned by both. The publicly verifiable records showed that Taxpayer and Husband jointly owned that cottage in question which was sold on November 7, 2012. Presumably, Taxpayer and Husband owned that property before August 17, 2012. As a result, Taxpayer was required to include the fair market value of that property in her assets.

Finally, in addition to stating she had $1,000 then, Taxpayer simply estimated the value of vehicles, household goods, books, retirement, and life insurance in her Worksheet without verifiable records. Even if, assuming Taxpayer's estimated value of the personal property owned by Taxpayer as they were, Taxpayer's assets were more than her liabilities immediately before the discharge on August 17, 2012.

In short, given the totality of the circumstances, in the absence of other verifiable supporting documentation, the Department is not able to agree that Taxpayer was insolvent immediately before the discharge of that $146,140 debt.

FINDING

Taxpayer's protest is respectfully denied.

March 28, 2018

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